No. 91-7804

In The

Supreme Court of the United States

October Term, 1992

SHELDON B. BUFFERD,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Second Circuit

REPLY BRIEF FOR PETITIONER

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QUESTION PRESENTED

Whether the statute of limitations bars adjustments to Petitioner's income tax return with respect to items arising from an S corporation's income tax return?

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ARGUMENT

I. RESPONDENT'S CENTRAL ARGUMENT IS FLAWED BY A CHRONOLOGICAL ERROR WITH RESPECT TO THE ENACTMENT OF SECTIONS 6037 AND 1378 OF THE CODE.

At the heart of Respondent's argument (R. Br. 15) is a newly-created legal theory: that Congress intended that a Form 1120S, annual income tax return of an S corporation, have two separate and distinct functions. In fact, Respondent's argument creates for the return a "split-personality," with each function or "personality" having a different period of limitations. There is no language in the statute or legislative history that refers to this dual function for the income tax return of an S corporation.

Respondent asserts that the first function or "personality" of Form 1120S is as "an 'information return' that sets forth detailed information on income and deductions and shows 'each shareholder's pro rata share of each item . . . for the taxable year' (26 U.S.C. 6037(a)) to assist in preparation of the individual shareholders' returns;. . . . " (R. Br. 15). Congress did not add the language "each shareholder's pro rata share of each item- . . . for the taxable year" in Respondent's quotation until three years after 1979[1], the year at issue in this case. After quoting language of a statute that is inapplicable to the year at issue, Respondent argues that this so-called information function does not have and never has had a period of limitations because the Commissioner could

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[1] Subchapter S Revision Act of 1982, Pub. L. No. 97-354, 96 Stat. 1669.

never "assess" a tax on that "personality." There is no doubt that since enactment in 1958[2], the *first sentence* of section 6037[3] requires every S corporation to file an annual return containing the information requested on Form 1120S. But there is also no doubt that the *second sentence* of section 6037, also enacted in 1958, states: "*Any return* filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as *a return filed by the corporation* under section 6012" (emphasis added). Thus, Congress contemplated in 1958 that the Form 1120S would be subject to a period of limitations exactly like the period to which any other corporate return filed pursuant to section 6012 would be subject. Section 6501(a) provides that period of limitations: three years from the date of filing the return.

Respondent asserts that the second function or "personality" of Form 1120S is "as the corporate return reporting taxes owed by the Subchapter S corporation in the limited circumstances in which the corporation may itself be liable for tax." (R. Br. 15). It was not until 1966, however, eight years after Congress enacted section 6037, that it added section 1378 to the Code.[4] Therefore, it was not until eight years after it enacted section 6037 that Congress first imposed a tax on an S corporation. Thus,

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[2] Technical Amendments Act of 1958, Pub. L. No. 85-866, § 64(c), 72 Stat. 1606, 1650-56.

[3] Unless otherwise indicated, all section references in this brief are to the Internal Revenue Code of 1954, 26 U.S.C. § 1 *et. seq.*, as in effect for 1979, the year at issue.

[4] Small Business Corporations Act, Pub. L. No. 89-389, § 2, 80 Stat. 111, 113-14 (1966).

from 1958 to 1966, the Form 1120S could have no second function or "personality."[5] Respondent argues in effect that from 1958 until 1966, section 6501(a) and the *second sentence* of section 6037 provided a period of limitations for a second function or "personality" that did not exist.

In 1958, the only circumstance that could cause an S corporation to be taxed was a failure to qualify for the benefits of subchapter S. In that case, the corporation would file a regular C corporation return. Therefore, Respondent's theory regarding the 1958 legislation and legislative history ascribes to Congress an intent in 1958 to impose a corporate income tax on an S corporation eight years later.

There was no language in section 1378, no amendment to section 6037 in 1966, and no language in the 1966 Committee Report[6] that indicated that Congress intended to create two distinct and separate functions and two different periods of limitations for the return that the *first sentence* of section 6037 required an S corporation to file. In fact, there is also no evidence that Congress contemplated in 1966 that the new tax imposed would be reported on the same Form 1120S return required by section 6037. Respondent's chronological error in interpreting section 1378 and the *second sentence* of section

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[5] Respondent's view renders Congress' inclusion of the *second sentence* of section 6037 mere surplusage from enactment of section 6037 in 1958 until Congress first imposed an S corporation level tax eight years later.

[6] S. Rep. No. 1007, 89th Cong., 2d Sess., 706, 711-13, reprinted in 1966 U.S. Code Cong. & Admin. News 2141, 2146-48.

6037, as if they were enacted at the same time, renders the *second sentence* of section 6037 meaningless between 1958 and 1966.

Respondent reaches this illogical result (as did the Second Circuit below) by attempting to analogize the income tax return of an S corporation to the return of a partnership, rather than to the return of a C Corporation. Although section 6031 requires a partnership to file a return that contains information similar to that required by the *first sentence* of section 6037 for an S corporation, section 6031 does not contain a second sentence similar to the *second sentence* of section 6037. The mistaken analogy, between an S corporation and a partnership, permitted the courts below to hold and Respondent to argue that the Second Circuit's holding in *Siben v. Commissioner*, 930 F. 2d 1034, *cert. denied*, 112 S.Ct. 429 (1991), relating to a partnership return, is controlling in this case. (*See*, P. Br. 25-30).

Respondent has sought to ignore the plain meaning of sections 6501(a), 6037(a), and 6012 and to look instead to the legislative history. Petitioner believes the Code is clear. Moreover, Respondent's interpretation of the example (quoted P. Br. 36) in the 1958 legislative history of section 6037 would swallow the whole statute and effectively write section 6012(a)(2) and the *second sentence* of section 6037(a) out of the Code. In 1958 there was no corporate level tax on an S corporation. In 1958, a determination that the corporation was not entitled to the benefits of subchapter S was the *only* occasion on which an S corporation could itself be subject to tax.

Respondent's retort (R. Br. 20, n.15) again ignores the chronology: Congress enacted the *second sentence* of section 6037(a) in 1958[7] and section 1378 in 1966.[8] In the footnote, Respondent asserts in response to Petitioner's interpretation of the example in the 1958 legislative history that the S corporation is subject to taxation "when it earns certain types of income described in 26 U.S.C. 1378 (1976) and when it becomes subject to the 'minimum tax.'." An S corporation did not become subject to these taxes under section 1378 until 1966; yet, Respondent argues that this tax is relevant in interpreting Congressional intent in 1958. When the example was written in 1958 there was no tax imposed against an S corporation and the *only* time an S corporation was subject to taxation was when it failed to qualify under subchapter S. Thus, Respondent has failed to refute Petitioner's contention that Respondent's interpretation of the example in the 1958 legislative history swallows the whole statute and literally repeals section 6012(a)(2) and the *second sentence* of section 6037.

Rather than Respondent's doubtful, strained interpretation of these interrelated statutory provisions, this Court must interpret the clear and unambiguous language of sections 6501(a), 6037(a), and 6012(a)(2) of the Code and their legislative history in a manner which supports Petitioner's position. Those provisions reveal Congressional intent that the statute of limitations runs

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[7] Technical Amendments Act of 1958, Pub. L. No. 85-866, § 64(c), 72 Stat. 1606, 1656.

[8] Small Business Corporations Act, Pub. L. No. 89-389, § 2, 80 Stat. 111, 113-14 (1966).

from the date the S corporation files its S corporation return (Form 1120S).[9] Therefore, for the Commissioner to adjust any items on the S corporation's return, the Commissioner must complete the adjustments within the three-year period of limitations provided by section 6501(a) for that return. This is true whether the adjustments would result in an assessment of tax liability against the S corporation itself or against another person whose income tax return is affected by the adjustments.

Respondent quotes from this Court's opinion in *Badaracco v. Commissioner*, 464 U.S. 386 (1983) (R. Br. 26) that "[c]ourts are not authorized to rewrite a statute because they might deem its effects susceptible of improvement." 464 U.S. at 398. Despite its own recitation of this rule, Respondent seeks to add additional language to both sections 6501(a) and 6037(a). Respondent argues (R. Br. 13) that section 6501(a) contains the language "against

[9] Respondent cites (R. Br. 14-15) *Germantown Trust Co. v. Commissioner*, 309 U.S. 304, 309-310 (1940) and *Commissioner v. Lane-Wells Co.*, 321 U.S. 219, 222-224 (1944) in an attempt to undermine the significance of an S corporation return as a return that may trigger the running of the limitations period under section 6501(a). Those cases focus on whether the information filed by a taxpayer who filed the wrong return or failed to file an additional required return was sufficient to constitute a "return" that would trigger the applicable limitations period. Those cases are inapposite to the case before this Court.

In this case, both the S corporation and its shareholder filed complete and timely income tax returns on Respondent's own tax forms. Respondent had adequate information for the applicable statute of limitations rules to apply. Respondent had the foresight to obtain an extension of the statute of limitations for Petitioner's income tax return, but failed to obtain such an extension for the S corporation's income tax return.

whom the tax is imposed" even though section 6501(a) contains no such language. Respondent then argues (R. Br. 18) that the *second sentence* of section 6037 contains the phrase "required to pay tax" after the word corporation even though section 6037 contains no such language. Without these additional phrases, the Second Circuit's (J.A. 72) view that an S corporation's period of limitations is only triggered if the S corporation itself is "required to pay tax" is unfounded. Thus, Respondent ignores its own cited quotation from *Badaracco* and requests that this Court add the words "against whom the tax is imposed" to section 6501(a) and the words "required to pay tax" to the *second sentence* of section 6037.

Petitioner recognizes that this Court, in interpreting section 6501(a) in *Badaracco*, held that courts should strictly construe statute of limitation provisions in favor of the government. But Petitioner is sure that this Court did not mean to accomplish this strict construction through the addition of words or phrases not present in the statute. Nor could this Court have intended its prescription to mean that whenever there is a statute of limitations issue, the government wins.

II. PETITIONER'S AGREEMENT TO EXTEND THE PERIOD OF LIMITATIONS DID NOT INCLUDE S CORPORATION ITEMS.

Respondent correctly notes that Petitioner's agreement to extend the statute of limitations (Form 872-A, J.A. 5) for 1979 "applied, by its terms, to adjustments relating

to 'any partnership (or any organization treated by the taxpayer as a partnership on the taxpayer's return).' " (R. Br. 4, n.5).

The agreement applied only to Petitioner's "distributive share" of partnership items or items from an entity that Petitioner treated as a partnership on his tax return. (J.A. 55-56). Petitioner was a partner in the partnership, Printer Associates, and he reported his distributive share of Printer Associates' items on his tax return. Petitioner was also a shareholder of Compo Financial Services, Inc., an S corporation. Compo was also a partner in Printer Associates.

The Commissioner's disallowance of Petitioner's distributive share of Printer Associates' partnership items is not, however, at issue in this case. Rather, this case concerns the Commissioner's disallowance of items arising from Petitioner's interest as a shareholder in Compo. Respondent contends that "the deficiency at issue in this case arose from Compo's erroneous treatment of partnership items." (R. Br. 13, n.10). That is irrelevant. The limitation contained in the extension agreement permitted a deficiency assessment only for adjustments to Petitioner's "distributive share" of partnership items or items from any organization treated by Petitioner as a partnership on his tax return. Compo was not a partnership.[10]

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[10] The statutory term "distributive share" is a term that applies only to partnerships and describes a partner's share of items of partnership income, gain, loss, deduction or credit. *See*, sections 702 and 704. S corporation shareholders, during the year at issue in this case, on the other hand, reported their "pro rata" shares of the corporation's undistributed taxable income and net operating loss. *See*, sections 1373 and 1374. The difference in statutory terminology stemmed from the recognition that a partnership was a more flexible business vehicle and partners may have had varying interests in different partnership items of income, gain, loss, deduction, or credit in accordance with the agreement of the partners. Shareholders had no flexibility in assigning their interests in corporate items of income, gain, loss, deduction, or credit; their interests were determined solely in accordance with their percentage stock ownership.

Nor did Petitioner ever treat any item arising from his interest in Compo as a partnership item. Therefore, Respondent cannot reasonably conclude that Petitioner stipulated that the deficiency notice was timely "because the deficiency at issue (both currently and at the time the extension agreement was made) concerns Compo's treatment of partnership items. . . . " (R. Br. 4, n.5). While it is true that Petitioner failed to contend in the Tax Court that the extension agreement was inapplicable to the partnership items, the Second Circuit declined to rule on whether Petitioner had waived his right to raise this issue. (J.A. 74).

Respondent's suggestion that Petitioner's Tax Court stipulations numbered 19 and 22 (J.A. 15) were somehow motivated by Compo's treatment of partnership items is unsupported by even a scintilla of evidence in the record. Rather, Petitioner's stipulation 22, that the deficiency notice was timely, incorporated by reference stipulation 19, which included the Form 872-A extension agreement as an attachment. That agreement clearly and specifically limited Respondent's ability to adjust items other than the limited class of items arising from an interest in a

partnership or an entity treated by the taxpayer on his return as a partnership. Therefore, stipulation 22 was limited by the terms of the Form 872-A and the notice of deficiency could be timely only with respect to the limited class of items arising from a partnership or from an entity treated by the taxpayer as a partnership on his tax return.

Respondent and Petitioner must both agree on the meaning of a stipulation or there is no meeting of the minds. If both Respondent and Petitioner did not agree on the limited nature of this stipulation 22, the stipulation should either be disregarded (*Stamos v. Commissioner*, 87 T.C. 1451 (1986)), or the case should be remanded to the lower courts for a determination of the limits of the stipulation. *See, The South Bay Corp. v. Commissioner*, 345 F.2d 698, 707 (2d Cir. 1965). As the Tax Court stated in *Stamos:* "Where language in a stipulation is so ambiguous that the intent of the parties cannot be discerned, the language in question will be disregarded, and the court will not construe a stipulation to exist where the parties have not clearly set forth the substance of what they have agreed to." 87 T.C. at 1455.

Respondent is mistaken in asserting that the Second Circuit foreclosed consideration of the effect of this limitation in the extension agreement. The Second Circuit noted that the printed Form 872-A contained a typewritten provision limiting any deficiency assessment to one resulting from an adjustment to Petitioner's distributive share from, basis in, or sale of any interest in "any partnership (or any organization treated by the taxpayer as a

partnership on the taxpayer's return)." (J.A. 73). The Second Circuit went on to note that Compo Financial Services, Inc. was not a partnership and that the taxpayer did not treat it as a partnership on his 1979 income tax return. (J.A. 73-74). Therefore, the extension granted the Commissioner by Bufferd did not by its terms reach the assessment of taxes resulting from an adjustment to S corporation items on Bufferd's income tax return.

Although the Second Circuit noted that Bufferd might have waived this theory by failing to make it before the Tax Court, the court observed: "Because of these considerations, and because Bufferd did not press this argument on appeal, even after a request for additional briefing on the issue by this Court, *we do not reach that issue.*" (J.A. 74) (emphasis added).

Thus, the Second Circuit considered but did not rule on whether the taxpayer had waived his right to make this argument as a result of his failure to brief and argue the meaning of the limitation in the courts below. *See, Stevens v. Department of the Treasury*, 111 S.Ct. 1562, 1567 (1991). In the interest of justice, however, this Court is free to consider the issue. *See, Youakim v. Miller*, 425 U.S. 231, 234 (1976); *and Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe of Oklahoma*, 111 S.Ct. 905, 910 (1991).

CONCLUSION

For the foregoing reasons, Petitioner requests this Court to reverse the judgment of the Court of Appeals or grant such other relief as the Court deems appropriate.

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